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C O N F I D E N T I A L SECTION 01 OF 03 DUBLIN 000606

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TAGS: EAIR ECON ETRD EFIN ELAB
SUBJECT: GOI UNVEILS AVIATION POLICY PACKAGE

Classified By: Political-Economic Counselor Mary E. Daly; Reasons 1.4 (B) and (D).

¶1. (C) Summary: On May 18, the Irish Government announced an aviation policy package that includes plans to sell a majority stake in Aer Lingus, the national carrier, and to build a second terminal at Dublin Airport. The package capped months of negotiations between the governing party, Fianna Fail, and its coalition partner, the Progressive Democrats, as to who would build and operate the new terminal. Critics, including opposition parties, have called the package a "fudge" for its failure to specify when, by what method, and how much of Aer Lingus will be sold. This lack of specificity could portend a delay in the carrier's privatization beyond the 2007 general elections, which would be safer for Fianna Fail, given the party's support among airline labor. Such a delay would also allow the GOI more time to see whether possible renewed U.S.-EU attempts to reach a trans-Atlantic Open Skies agreement might provide the carrier greater access to the U.S. market. End summary.

The Aviation Package

¶2. (U) On May 18, the Irish Cabinet approved a long-awaited package of policy measures for the aviation sector. The package's key components include plans to: (1) sell a majority stake of Aer Lingus, the national carrier; (2) build a second terminal at Dublin Airport by 2009, to be owned by the Dublin Airport Authority (DAA); (3) conduct an open tender to choose the second terminal's operator; (4) construct a new pier for aircraft parking stands at Dublin Airport by 2007; and, (5) prepare to build a third terminal when the yearly passenger volume for the first two terminals combined reach 30 million (likely by 2015). Aer Lingus Chairman John Sharman and the DAA issued statements welcoming the package, which Transport Minister Martin Cullen described in a news conference as the "first-ever comprehensive plan for the long-term success and growth of Irish aviation."

¶3. (U) The package caps several months of negotiations between the governing party, Fianna Fail, and its coalition partner, the Progressive Democrats. (Willie Walsh's resignation as Aer Lingus CEO last November, due to government indecision on Aer Lingus, future, catalyzed the negotiations.) Although the two parties had agreed by late 2004 to privatize Aer Lingus, attempts to secure Cabinet approval faltered over differences on Dublin's new airport terminal. The Progressive Democrats, who campaign on a free-market platform, had pressed for the private sector rather than the DAA, a state body, to build and operate the terminal. Fianna Fail, with several parliamentary seats in Dublin constituencies and strong labor support at the airport, preferred the DAA to be the terminal's builder and operator. The final package was a compromise, whereby the DAA would build the terminal, but would compete with private parties for the right to operate it.

Unanswered Questions

¶4. (U) Several significant questions remain, however, regarding the privatization of Aer Lingus, which posted a final, pre-tax profit of euro 1.2 million in 2004 after dedicating euro 98 million from its operating profit to severance packages for 730 staff. Minister Cullen declined to specify the percentage share of the carrier that would be sold and the timing and method of the sale. He said that advisors would be chosen to make recommendations on these issues, but added that the Government would keep at least a 25 percent share. (With Aer Lingus, 3,500 employees holding a 14.9 percent stake, a 25 percent Government share would mean that, at most, a 60.1 percent share would be offered to investors -- 10 percent less than was recommended by a government-commissioned Goldman Sachs report in 2004.) According to the Irish Times, the Government also seeks to ensure that private investors will retain the Aer Lingus brand name and the carrier's 44 daily Heathrow slots (variously valued at euro 300 million or above), but has not specified the method for doing so. Moreover, there has been no public discussion of the possibility that Aer Lingus, if majority-owned by non-Irish citizens, might forfeit rights under the U.S.-Irish aviation agreement.

¶5. (U) Questions also surround the second airport terminal, which the DAA has estimated will cost euro 130 to 190 million

to build, with possible ancillary costs of euro 100 million. The DAA has not clarified where it plans to build the terminal, although it is considering two sites on property that it owns. Funding for the terminal is also an issue, since the DAA has debt worth euro 400 million. Minister Cullen stated that the new terminal's operator would have to respect the wage/benefit terms and union rights that were reached in last year's national wage bench-marking agreement, known as "Sustaining Progress." (This condition was included to secure labor buy-in to an open tender process for operating the second terminal, since competition between the terminals might otherwise have entailed pay and staff cuts.) Cullen did not clarify, however, how these terms would be protected after the expiry of Sustaining Progress in roughly 18 months, well before the new terminal's expected completion in 2009.

Criticism of the Package

¶6. (U) The aviation package prompted criticism from several quarters. Ryanair CEO Michael O'Leary threatened legal action to block construction of the new terminal and faulted Prime Minister Ahern for breaching 2002 election campaign promises to allow the private sector to develop the structure. The McEvaddy Brothers real estate development firm, which owns 150 acres adjacent to the airport and wishes to build the new terminal, also said that it would pursue action against the Government under national and EU competition law. Opposition political parties jointly described the aviation package as "a fudge" for its lack of clarity on when, how, and how much of Aer Lingus would be sold. A May 20 Irish Times editorial also referred to the package as "a fudge," saying that it "demonstrated a serious lack of coherence and joined-up thinking in Government about how Irish air travel and its facilities can be developed."

Aer Lingus and the U.S.-Irish Agreement

¶7. (C) The time frame for Aer Lingus, privatization remains "up in the air," Colin Hunt, Special Advisor to Minister Cullen, told Emboff on May 20. Hunt noted that the Department of Transport would place a public tender in the coming days advertising for advisors on the sale of the carrier's majority stake. These advisors would likely need six months to make their recommendations, making possible a placement with investors by the third quarter of 2006. Hunt cautioned, however, that that the timing of the sale, which he believed would take the form of an IPO for retail investors, could slip beyond that target. He added that the proceeds of the sale would go toward the estimated euro 1 billion needed to purchase eight or nine long-haul aircraft, which Aer Lingus hoped to put on new routes to North America, the Middle East, Asia, and Africa.

¶8. (C) Hunt acknowledged that new North American routes would depend on liberalization of the U.S.-Irish aviation agreement, which Minister Cullen aimed to pursue as part of the aviation package. Hunt recalled that Irish negotiators had conveyed Cullen's support for an Open Skies arrangement during April discussions with USG counterparts. The Irish side, however, was unable to conclude such an arrangement because of the likelihood of legal action against Ireland by the Commission. Cullen planned to address this legal bar with EU Transport Commissioner Barrot during a planned late May/early June meeting in Dublin as well as in the Transport Council meeting later in June. In those discussions, Cullen would emphasize the unfairness inherent in allowing 15 Member States to maintain Open Skies while preventing others, like Ireland, from negotiating such agreements -- a situation that, according to Hunt, contravened the principles of fair competition in the EU common aviation market.

Factors Determining Investor Interest in Aer Lingus
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¶9. (C) An institutional placement would be the likely vehicle for selling Aer Lingus, majority stake, as opposed to a retail/stock market float, Emboff was told on May 20 by Joseph Gell, aviation portfolio manager for Goodbody Stockbrokers, one of Ireland's largest financial houses. Gell said that floating the carrier's shares to retail investors would be too risky, given the possibility that the shares could tank before the 2007 general elections (just as share values in Eircom fell immediately after the then-state-owned phone company's stock was floated to retail investors in 1999). Fidelity, Wellington, and Janus would probably express interest in an institutional placement for Aer Lingus. These funds, however, inclined toward investments in low-cost carriers, like Southwest, and would focus on Aer Lingus, plans for competing on short-haul routes with Ryanair and easyJet. Gell observed that the new Aer Lingus CEO, Dermot Mannion (formerly of Emirates), would need until late 2005 to assemble a management team and put forward the carrier's business plans. Institutional

investors would also want to see the level of union buy-in to these plans, since Aer Lingus would have to countenance further staff cuts to compete with the likes of Ryanair.

¶10. (C) Other factors would also determine investors, interest in Aer Lingus, said Gell. For example, although the carrier was profitable, its estimated pension deficit was euro 200 million. Aer Lingus, long-haul strategy was a question too, since it recently announced plans to stop service to Orlando due to lower-than-expected earnings on the route. This decision, along with the recent cessation of Baltimore service and disappointing earnings on Los Angeles service, seemed to contrast with Aer Lingus, reported aspirations to expand trans-Atlantic service in the context of a liberalized U.S.-Irish bilateral agreement. Gell said that the retention of a government share in Aer Lingus would deny investors a free hand with the airline, but would not scare off investment, just as government shares in Lufthansa and Air France had not deterred private investment in those carriers. Gell believed that Aer Lingus could be valued at euro 300 to 900 million at the time of placement, depending on the cost of fuel prices, the overall state of the aviation sector, and the quality of the carrier's business plan.

Comment: A Decision to Delay

¶11. (C) The aviation package represents a decision not so much to privatize Aer Lingus as to delay privatization. The process could conceivably stretch beyond the 2007 elections, which would be safer for Fianna Fail, given the party's support among airline labor. Another advantage to this delay is that Ireland would have more time to sort out the issue of liberalizing U.S.-Irish aviation relations. As the Department of Transport and financial experts have conveyed to Post, liberalization that would allow Aer Lingus additional access to the U.S. market would presumably enhance the carrier's value ahead of an institutional placement or stock market float. After declining to commit to an Open Skies arrangement in April, the Irish Government seems prepared to see whether bilateral liberalization can be achieved via possible renewed U.S.-EU attempts to reach a trans-Atlantic Open Skies accord. If such attempts do not materialize or succeed, the Irish believe that they would have a stronger case to make to the Commission to pursue a bilateral solution, even in the face of the Commission's legal objections.
KENNY